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IN THE

Supreme Court of the United States

OCTOBER TERM, [redacted] 1958

FORD MOTOR COMPANY, *Petitioner*,

v.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

CLARENCE E. DAWSON,
Attorney for Petitioner
821 Fifteenth Street, N.W.
Washington 5, D. C.

WILLIAM T. GOSSETT
ALAN L. GORNICK
L. HOMER SURBECK
JAMES A. LEE
Of Counsel.

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Petitioner prays that a Writ of Certiorari be issued to review the judgment of the Court of Claims in the above entitled case.

OPINION BELOW

The opinion of the Court of Claims (R. 77) is reported at Ct. Cl. , 156 F. Supp. 554. (Appendix B).

JURISDICTION

The judgment of the Court of Claims sought to be reviewed was entered on December 4, 1957. (R. 77) Within the period of time extended for that purpose by the Court of Claims by order dated January 8, 1958, petitioner filed a timely petition for rehearing which was denied by order of the Court of Claims

entered on April 2, 1958. (R. 79) Jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTIONS PRESENTED

Petitioner claims refund of that portion of the manufacturers excise tax paid on sales of automotive vehicles, parts and accessories which is proportionate to rebates made to purchasers on account of defects in materials or workmanship between August 1, 1949 and December 31, 1954.

The questions presented are:

1. Whether cash payments or cash credits made or allowed by a manufacturer to its vendees, pursuant to an express warranty in respect of defects discovered within the warranty period are price readjustments by "rebate or allowance" within Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

2. Whether cash payments or cash credits made or allowed by a manufacturer to its vendees pursuant to its practice or policy of adjustment, in respect of defects discovered within or beyond the warranty period, are price readjustments by "rebate or allowance" within Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or im-

porter, a tax equivalent to the following percentages of the price for which so sold:

(a) Automobile truck chassis, automobile truck bodies, automobile bus chassis, * * * tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum,[1] * * *.

(b) OTHER CHASSIS AND BODIES, ETC.—Other automobile chassis and bodies, * * * (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum,[2] * * *.

(c) Parts or accessories * * * for any of the articles enumerated in subsection (a) or (b), 8 per centum,[1] * * *.

(26 U.S.C. 1952 ed., Sec. 3403.)

SEC. 3441. SALE PRICE.

(a) In determining, for the purposes of this chapter, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to

[1] 5 per centum prior to Nov. 1, 1951.

[2] 7 per centum prior to Nov. 1, 1951.

the satisfaction of the Commissioner, in accordance with the regulations.

(b) If an article is—

(1) sold at retail;

(2) sold on consignment; or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price;

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 3441.)

SEC. 3443. CREDITS AND REFUNDS.

(a) A credit against tax under this chapter, or a refund, may be allowed or made—

* * * * * * * * * *

(2) to any person who has paid tax under this chapter with respect to an article, when the price on which the tax was based is readjusted by reason of return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance; in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 3443.)

The corresponding provisions of the Internal Revenue Code of 1954 are essentially the same. They are set forth in Appendix A.

Pertinent regulations are set forth in Appendix A.

STATEMENT

The petitioner is a manufacturer of passenger automobiles and trucks, and parts and accessories therefor, and sells such products to its authorized dealers, who are not the agents of the petitioner but who purchase for resale as principals.

In connection with sales of its products, petitioner, by written instrument given to its vendees, expressly warranted its products to be free from defects in material and workmanship for the period prior to either (1) the time such product had been driven, used or operated for a distance of 4,000 miles, or (2) 90 days from the date of delivery of such product to the original retail purchaser thereof, whichever event first occurred. (Pet., par. 5, R. 2).

In addition to the express warranty, it was petitioner's policy, under certain circumstances, to pay to its vendees the cost of repair or replacement of its products found to be defective both within and beyond the periods stated in the express warranty. (Pet., par. 6, R. 2).

No extra charge was made for the express warranty or costs to be incurred under petitioner's policy. Instead, the sales prices included a charge in respect of adjustments to be made pursuant to the warranty or pursuant to petitioner's policy. (Pet., par. 7, R. 2).

Sales prices of petitioner's products, on which petitioner paid manufacturers excise taxes, were readjusted during the periods in suit by cash payments made or cash credits allowed to its vendees pursuant to said warranty and pursuant to said policy. (Pet., par. 8(a), R. 63).

The petitioner brought suit in the Court of Claims under 28 U.S.C., Section 1491, claiming refunds aggregating $8,899,547.53, on the ground that the cash payments made, and cash credits allowed to its vendees were price readjustments by "rebate or allowance" for which a proportionate tax credit or refund is allowable under Section 3443(a)(2) of the Internal Revenue Code of 1939 and under Section 6416(b)(1) of the Internal Revenue Code of 1954.

REASONS FOR GRANTING THE WRIT

1. The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court for the guidance of manufacturers generally and for orderly administration of the Statute.

The question presented is one of importance generally to manufacturers subject to the Federal Manufacturers Excise Tax. At least twenty-four suits are now pending in the Court of Claims or in Federal District Courts involving the question of excise tax refunds in connection with manufacturers' warranties.

Every manufacturer has the problem of arranging its program for handling possible defects in its products. Certainty in the application of the sections of the statute here involved is necessary to enable programming in terms of predictable tax consequences. But such programming is not now possible for lack of a precise and authoritative interpretation of the taxing and refund provisions of the statute.

The refund provisions of the statute seem clearly to cover price readjustments on account of warranted defects whether effected by reason of *either* (a) re-

turn of the defective article *or* (b) rebate or allowance paid or credited to the purchaser without return of the article.

Confusion as to the precise application of the refund provision arises, however, by reason of the recent conflicting Court of Claims decisions.

In a series of recent *Frigidaire* cases, the Court of Claims (1) first recognized that expenditures to remedy a defect were an "allowance" within the refund provision; then (2) repudiated the "allowance" concept, but (3) ruled that alternative relief might be had in the case of an extraordinary warranty beyond the customary period by way of an "exclusion" from the taxable price of the cost of such extra warranty where a separate charge had been made to the vendee for such a warranty. Apparently no relief was recognized in respect of a customary warranty for the usual period.

In the *Ford* decision, for which review is here sought, the "allowance" concept was rejected for reasons which seem both unsound and without support in the statute.

Authoritative ruling by this Court on the questions here presented is required to clarify the controlling principles for the guidance of manufacturers and for orderly administration of the excise tax.

2. Confusion confronts manufacturers as a result of the four recent Court of Claims decisions.

The first three decisions each involved the Frigidaire Division of General Motors. The fourth is the *Ford* decision for which review is here sought.

The *Frigidaire* cases involved two express warranties: A one year warranty, and a five year warranty.

The first and second cases dealt with the five year warranty, the $5.00 cost of which was separately stated in the price the vendee was required to pay. Plaintiff sought refund on alternative grounds: (1) As an "allowance" [under Internal Revenue Code of 1939, Sec. 3443(a)(2)] for the cost of fulfilling the five year warranty; or (2) on the basis of "exclusion" from the purchase price [under Internal Revenue Code of 1939, Sec. 3441] of the extra $5.00 charge for the warranty. The Court recognized the "allowance", but rejected the "exclusion."

Relying on the first and second cases, plaintiff in the third *Frigidaire* case sought refund of excise tax proportionate to its costs in respect of the one year warranty as well as its costs in respect of the five year warranty. But the Court rejected "allowance" as to either warranty, and instead recognized "exclusion" with respect to the extra charge for the five year warranty.

One may surmise that the Court felt impelled to grant some relief with respect to the five year warranty, but was beset with the problem of doing it on some basis which would not include the one-year warranty. This led to unsound distinctions which leave in doubt the circumstances of availability of both "allowance" and "exclusion."

The distinctions drawn between the one year and five year warranties for the purpose of differentiating their treatment are without substance.

The first distinction was on the basis of the $5.00 extra charge which the Court held invoked the "exclusion" theory. But the "exclusion" from price was permitted subject to the limitation that only that part

of the $5.00 which bears "a close relationship to the actual cost of rendering the [warranty] service" (*General Motors* v. *United States*, Ct. Cl. , 147 F. Supp. 739, 740 (1957)) can be recognized as an "exclusion" from the price. As pointed out in the dissent, however, under the "exclusion" theory, the entire $5.00 would have to be excluded as the price received for a non-taxable item—the warranty contract. Clearly, when the "exclusion" is based not upon non-taxable price, but instead on subsequent cost of rendering the warranty service, the principle really involved is "allowance" which, being based on actual cost, is obviously as applicable to the one year warranty as to the five year warranty. Thus this distinction relied on to deny refund in respect of cost of fulfilling the one year warranty is without substance.

The second distinction was that the one year warranty is customary in the trade and thus analogous to an implied warranty and therefore different from the five year extra warranty. The concept apparently is that the implied warranty is, as a matter of law, inseparable from the article sold, so that the purchaser receiving the benefits thereof is simply enjoying a built-in feature of the article bought.

But the analogy is invalid. Express warranties derive solely from a special agreement, which may specifically exclude the implied warranty otherwise inhering in the article. There is no necessary relationship between the scope and duration of an express warranty, whether or not customary, and the warranty otherwise implied by law. This was pointed out by Judge Madden in the first *Frigidaire* case, [128 Ct. Cl. 465, 467-8, 121 F. Supp. 932, 933-4 (1954)]

with specific reference to the one year express warranty there involved. There was thus no sound basis in that case for treating the customary one year express warranty differently from the five year warranty on the theory that the one year warranty was analogous to an implied warranty.

Furthermore, according more favorable treatment to a five year warranty, on the ground that it is not customary, is an unsound basis for distinction because the unusual warranty may well become customary by reason of its advantageous tax consequences.

The development of the present confusion in the law is easily traced.

In the first *Frigidaire* case [128 Ct. Cl. 465, 121 F. Supp. 932, cert. denied 348 U.S. 942 (1955)]:

> (a) The Court indicated that there is no material distinction between the two express warranties: the customary express warranty for a one year period, and the express warranty for a longer period of five years.
>
> (b) The Court held that the costs of fulfilling the five year warranty constituted readjustments of price by means of an "allowance" within the meaning of the statute.

On the latter point, the Court said (121 F. Supp. 935):

> "* * * When an article is sold with a warranty, and fulfillment of the warranty costs the seller a certain sum, he has in fact received for the article only the amount by which the sale price exceeded the cost of fulfilling the warranty. He

has, in effect, given the purchaser an 'allowance' when he has spent money for his benefit. * * *".

The second *Frigidaire* case [*General Motors* v. *United States*, Ct. Cl. , 146 F. Supp. 220 (1956)] reaffirmed the holding in the first case.

The third *Frigidaire* case [*General Motors* v. *United States*, Ct. Cl. —, 147 F. Supp. 739 (1957)], however, repudiated the views expressed in the first case:

(a) A distinction was taken between an express warranty for the customary one year period, and an express warranty for a five year period; the one year warranty was analogized to an implied warranty whereas the five year warranty was not.

(b) Because there was an "extra charge"—which "was not a part of the sales price"—for the five year warranty, the Court decided that "exclusion" from the sales price, rather than "allowance," was the appropriate relief.

(c) It was held that no "allowance" was available in respect of the one year warranty because it was analogous to an implied warranty, and because there was no "extra charge" for the one year warranty.

(d) Presumably, "exclusion" was not available with respect to the one year warranty either because no "extra charge" was made for it, or because it was analogized to an implied warranty, or because of both reasons.

In the fourth decision—the *Ford* case, for which review is sought—the Court of Claims, indicated a view apparently different from that expressed in the third *Frigidaire* case:

(a) It held that there was no distinction between Ford's express warranty for the customary period and its policy beyond such period.

(b) It analogized (necessarily by implication) not only the customary warranty, but also the extra policy, to an implied warranty.

Since all express warranties appear now to be in the category of implied warranties—for which the Court of Claims has denied "allowance"—it is not clear just what a manufacturer must do to avail himself of the "allowance" provision of the statute.

Moreover, a reading of the *Ford* decision together with the third *Frigidaire* case suggests the likelihood that the "exclusion" permitted in the latter case may no longer be available. While *Frigidaire* permitted "exclusion" for an extra warranty, for which there was an extra charge, "exclusion" was presumably denied for the customary warranty for lack of an "extra charge," and because analogized to an implied warranty. But, under the *Ford* decision, apparently all warranties, adjustment policies or practices are now to be treated as implied warranties—at least where there is no separately stated "extra charge."

Thus, the "extra charge" appears to be the only basis left for granting an "exclusion." But this would not appear to be a tenable basis for determination of important tax consequences. Mere separate statement to the purchaser of "extra charge" for the warranty

is clearly a meaningless formality not supported by the statute. The only ground for an "exclusion" is the "other charge" provision in the statutory definition of price [Internal Revenue Code of 1939, Sec. 3441(a)] which turns not upon separate statement, but rather upon whether the amount thereof is satisfactorily established.

We are therefore left by the cases without any satisfactory criterion to guide a manufacturer in programming for an "exclusion" if indeed that remains available.

Thus, these Court of Claims decisions have not only left the availability of "allowances" generally in doubt, but have added to the confusion by leaving uncertain the availability of "exclusion" as an alternative to "allowance."

3. The *Ford* decision requires clarification for the further reason that it is uncertain whether it rests upon facts in the petition or is limited to the facts assumed in the opinion.

It is error for a court to grant judgment for the defendant on the pleadings unless, as a matter of law, no facts could be proved under the allegations to sustain recovery. *Michel* v. *Meier*, 8 F.R.D. 464, 470 (W.D. Pa. 1948). In view of this, the *Ford* decision might be taken as purporting to be applicable to every state of facts provable under the allegations.

But the rulings in the *Ford* decision appear to be addressed only to specific *assumed* facts, for the pur-

Sales prices of petitioner's products include a charge for the warranty and its policy. Pet. par. 7, R. 2, which is not separately stated.

pose of bringing the case within the ambit of the third *Frigidaire* case, instead of being based on the materially different facts stated in, and provable under, the allegations in the *Ford* petition. One example will suffice to illustrate this point.

The petition alleges (par. 6, R. 2) that, "in addition to the express warranty, * * * it was the established policy of plaintiff, as set forth in certain written communications to its authorized dealers, to repair or replace or bear the cost of the repair or replacement" of items found to be defective, but not covered by the express warranty. Under these allegations, it is open to the petitioner to prove the voluntary character of the benefits accorded under the policy as distinguished from the contractual obligation of the express warranty. Thus, benefits which might be received by the vendee under such a policy are in addition to what a purchaser "contracted to buy" or had a right to receive.

But in the *Ford* decision, the Court of Claims assumed that the policy was contractual, not voluntary, and thus did not differ from the express warranty. The Court said (Appendix B, infra, p. 5a; R. 78):

> "* * * [Company expenditures under the policy] were made in a liberal interpretation of the *obligation* of the seller to deliver a sound article, as an *agreed* extension of its *obligation* under the warranty. That the defect appeared after the *warranty* period, strictly construed, makes no difference. The expenditures were still made to give the purchaser what he had *contracted* to buy, and in accordance with the seller's policy of which the purchaser had been informed before the sale * * *." (Emphasis added.)

In the context of this case—where petitioner was not permitted to prove the voluntary character of its policy—does the foregoing ruling preclude "allowance" in respect of gratuitous adjustments, i.e. after the warranty period, or is the ruling restricted by its phraseology to contractual adjustments in order "to give the purchaser what he contracted to buy?"

4. The decision below is erroneous and should be reviewed by this Court.

Under the statute, the tax is imposed upon "articles sold by the manufacturer" (Internal Revenue Code of 1939, Sec. 3403). The measure of the tax is the price for which the article is sold which, presumably, is its fair value. Thus, under specified circumstances where articles are sold otherwise than at fair value, provision is made (Internal Revenue Code of 1939, Sec. 3441(b)) for tax on the basis of such fair value rather than the price of the particular sale.

As stated in the *Ford* decision (Appendix B, infra, p. 5a; R. 78), "The sales price was for an article free of defects." Logically, the fair value of a defective article would be less than the sales price for an article free of defects. It is accordingly entirely consistent with the policy of the statute that the tax on a defective article should be less than the tax in respect of an article free of defects. Thus, if the price of an article is readjusted in order to reflect the lower value by reason of a defect, a proportionate part of the tax paid on the original price should be refunded.

The statute provides generally for proportionate refund of the tax when the price on which the tax is based is readjusted by either return of the articles or by rebate or allowance.

It is unsound for the Court of Claims to argue that adjustments pursuant to an express warranty are not price readjustments entitling a manufacturer to a refund on the ground that the vendee had neither gained nor lost but had only received that for which he contracted.

Under the general law, it is competent for the manufacturer to agree with the purchaser upon the terms of an express warranty to the exclusion of any implied warranty. Consistent with the above indicated provisions and policy of the statute, it is competent for them also expressly to provide that, in the event of discovery of a defect within a stated period, there shall be a readjustment of the price (on which the tax is based) and that such readjustment may be made by cash payments or cash credits.

Readjustment of price pursuant to any such contract is a recognition that the article actually sold had a fair value less than the price paid, and that the amount of the readjustment so made merely reflects the difference in value. The net result is precisely the same whether the express warranty is phrased in terms of price readjustment or simply in terms of replacement, repair or cash credits.

The Regulations recognize that price reductions by way of rebates may be made pursuant to contract, as, for example, where the sale agreement provides for a rebate in the event of a price reduction by the manufacturer applicable to articles remaining unsold in the hands of the dealer (Regulations 46, Sec. 316.13(c)). Obviously the whole purpose of any such contract, like the express warranty, is to avoid gain or loss on the part of the purchaser by reason of the

event with respect to which the stipulation is addressed. It is therefore unsound to argue, as the Court did in the *Ford* decision, that adjustments made pursuant to an express warranty are not readjustments of the sales price pursuant to contract because the purchaser neither gained nor lost anything by fulfillment of the contract or obligation.

Actually, however, the position of each party is changed by reason of any readjustment of the price pursuant to contract. To use a warranty contract for example, suppose that a manufacturer sells for $2,000 a car which has a defect which requires the expenditure of $200 to correct. Presumably, the fair value of the defective car as sold is $1,800. If the manufacturer makes a refund of $200 on account of the purchase price, the purchaser has in effect received a price readjustment reflecting the true value of the article which he actually purchased.

It would be possible for the manufacturer to exclude by contract all warranty liability. Therefore, except for the provision of the express warranty, the purchaser (1) would have a defective article for which he paid $2,000, and (2) would be obliged to expend an additional $200 out of his own pocket in order to correct the defect. But by reason of the express warranty, the $200 required to correct the defect is paid or credited to him. Not having to expend $200 out of his own money to correct the defect, he has by virtue of the express warranty in effect received a readjustment in price for the defective article in the amount of $200. The manufacturer, on the other hand, has in effect received only $1,800 the fair value—of the defective article which he sold.

Excise tax was paid on the basis of a value of $2,000. By virtue of the payment under the express warranty, there has been a "rebate" of $200 for which the manufacturer is entitled to a proportionate excise tax refund or credit under the statute.

The Court was, of course, in error in viewing the *Frigidaire* case as controlling here. The facts are quite different.

In *Frigidaire*, there was no readjustment in the price paid to the manufacturer by its vendee. This is evident in two respects: (1) The manufacturer itself directly repaired defective parts in the hands of ultimate consumers. The transaction in no way affected or concerned the manufacturer's vendee from whom it received the purchase price which was taxed. Thus, the Regulations (Regulations 46, Sec. 316.13), dealing with "discounts and adjustments generally" precluded any rebate:

> "(d) * * * allowances, payments or adjustments made to persons other than the manufacturer's vendee are not deductible from the sales price under any conditions for purposes of computing the tax."

(2) The manufacturer replaced in kind and made no cash credit or rebate to anyone. The *Frigidaire* case is thus clearly outside the wording of the refund section of the statute.

But in the *Ford* case, (1) the manufacturer dealt exclusively with its vendee who paid the purchase price taxed and who received the "rebate," and (2) the manufacturer made adjustments only by way of cash payments and credits as distinguished from re-

placements in kind. Thus, on the facts, the *Ford* case is clearly distinguishable from the *Frigidaire* case.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

CLARENCE E. DAWSON,
Attorney for Petitioner

WILLIAM T. GOSSETT
ALAN L. GORNICK
L. HOMER SURBECK
JAMES A. LEE
Of Counsel.

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